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Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

KOCH OIL COMPANY,

Petitioner,

v.

COMMITTEE OF CREDITORS HOLDING UNSECURED CLAIMS AGAINST POWERINE OIL COMPANY, DEBTOR IN BANKRUPTCY,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITIONER'S REPLY BRIEF

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PETITIONER'S REPLY BRIEF

The brief of Powerine Oil Co.'s unsecured creditors in opposition to certiorari squarely joins the issue on the question presented by the Ninth Circuit's decision in this case, namely, whether the venerable "diminution of the estate" doctrine is to be observed in applying the voidable preference test of the Bankruptcy Code? The respondent creditors maintain that it should not be—that whether or not a pre-bankruptcy transfer of a debtor's assets results in a diminution of the estate available to the creditors of the same class as the transferee makes no difference in determining whether the transfer is voidable under Section 547 of the Code. The creditors dismiss the doctrine as a relic of the Bankruptcy Act of 1898 that is inapplicable under the present Code. Brief in Opposition p. 8.

The respondent creditors acknowledge that they would have received nothing in a Chapter 7 liquidation of Powerine regardless of the transfer to Koch because "there was a general lien in favor of the Secured Lenders, whose claims far exceeded the value of all Powerine's assets." Brief in Opposition p. 6 fn. 6. Their interest in having the transfer to Koch voided springs from a side agreement reached with the secured creditors as part of a reorganization plan under which they would receive a bounty of 50% of any amount recovered from Koch. Brief in Opposition p. 4.

The unsecured creditors downplay the complete novelty of the Ninth Circuit's finding that the transfer to Koch was voidable under these circumstances—portraying the ruling as merely a reaffirmation of an unremarkable principle recognized in prior case law. Upon examination, however, each of the decisions the creditors point to in support of that contention, proves to differ from this case in a critically important respect: each was decided in a factual context where the transfer alleged to be voidable *would have* resulted in a diminution of the estate available to creditors and the opinion in each case reflects an awareness that the "diminution" principle continues to be *the defining characteristic* of a preferential transfer in bankruptcy law.[1] Unlike the Ninth Circuit, these courts

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[1] "[W]e cannot accept the contention that a creditor's security interest in an asset of an entity not in bankruptcy . . . enables the creditor to elect to draw from the bankruptcy estate 100% of the debt owed, *at the expense of the debtor's other creditors.*" [emphasis supplied]. *In re Virginia-Carolina Financial Corp.*, 954 F.2d 193, 198 (4th Cir. 1992). "The focus instead must be on *the effect which the transfer has had upon the debtor's estate.*" [emphasis supplied]. *In re El Paso Refinery, L.P.*, 178

(continued...)

would not have found a voidable preference had the transfer at issue not resulted in a diminution of the estate.

The creditors' assertion that standby letters of credit easily can be adjusted to accommodate the Ninth Circuit's novel holding is not persuasive. No doubt, for a price, standby letters of credit could be written to extend the issuer's obligations beyond the payment of the underlying debt for such period of time as would be necessary to eliminate the possibility that the payment could be voided in a bankruptcy proceeding. But that would require securing the issuer for that period of time, as well. The unique utility of a standby letter of credit lies in its stake holding function, which affords a debtor the option to pay the underlying debt out of the deposits securing the issuing bank. Extending the issuer's exposure on the letter of credit beyond the use of these deposits to pay the underlying debt would defeat the purpose of a standby letter of credit.

The Ninth Circuit's ruling needlessly cabins an instrument of commercial finance that has proven enormously useful to bankers and businesses for many years. This Court should take this opportunity to dispel the notion that Congress intended to abandon the "diminution of

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[1] (...continued)
B.R. 426, 432 (Bankr. W.D. Tex. 1995). "[I]f, in the case now before the court, funds remained to be drawn on the letters of credit that equaled or exceeded the debtor's payment . . . , a finding that the transfer was preferential *would not benefit the estate.*" [emphasis supplied]. *In the Matter of Formed Tubes, Inc.*, 41 B.R. 819, 821 (Bankr. E.D. Mich. 1984) (explaining the relevance of determining the net effect of transfers on the size of the fund available to satisfy the claims of general creditors.)

the estate" doctrine when it enacted the voidable preference provisions of the Bankruptcy Code in favor of the novel dog-in-the-manger interpretation of the preference provisions espoused by the Ninth Circuit in this case.

CONCLUSION

For the reasons stated herein, and in the Petition, this Court should grant the writ and reverse the decision below.

Respectfully submitted,

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